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In the Supreme Court of the United States

October Term, 1953

No. 39

ANTHONY WILKO, *Petitioner*

v.

JOSEPH E. SWAN, et al., individually and doing business under the firm name and style of HAYDEN STONE AND CO., et al.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

OPINIONS BELOW

The opinion of the Court of Appeals (R. 40-49) is reported in 201 F. 2d 439 [1] The opinion of the District Court (R. 23-32) is reported in 107 F. Supp. 75.

[1] The Court of Appeals' decision is discussed in 62 Yale L. J. 985 (1953); 66 Harv. L. Rev. 1326 (1953); 53 Col. L. Rev. 735 (1953); 41 Geo. L. J. 565 (1953).

JURISDICTION

The judgment of the Court of Appeals was entered on January 15, 1953 (R. 52). The petition for a writ of certiorari was filed on April 14, 1953, and granted on June 1, 1953. 345 U. S. 969. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254. See also Section 22(a) of the Securities Act of 1933, 15 U.S.C. § 77v(a).

QUESTION PRESENTED

Whether an agreement to arbitrate an alleged cause of action under the civil liabilities provisions of Section 12(2) of the Securities Act of 1933, obtained by a securities firm from a customer at the initiation of their dealings, is valid and enforceable in view of the purpose of Congress to accord a defrauded purchaser the special statutory court remedy provided by Section 12(2), and in view of the provisions of Section 14 of that Act invalidating agreements to waive compliance with the statute.[2]

---

[2] The determination below also presents the question whether the provisions of the Federal Arbitration Act for vacating an award (9 U.S.C. § 10) empower a court to compel the arbitrators to comply with an agreement which (as construed by the court below) requires them to conduct the equivalent of a court proceeding. The Commission has no distinct statutory interest in the proper construction of the Federal Arbitration Act, but discusses this question to the extent that it is pertinent to the principal question set forth in the text.

STATUTES INVOLVED

The following are the pertinent provisions of the Securities Act of 1933, 48 Stat. 74, as amended:

Section 12(2), 15 U.S.C. § 771(2):

> Any person who—
>
> * * * * * *
>
> (2) sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such secu-

rity, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States, the United States courts of any Territory, and the Supreme Court of the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to re-

view as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. * * *

The Federal Arbitration Act, 43 Stat. 883, provides:

9 U.S.C. § 3:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 10:

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(a) Where the award was procured by corruption, fraud, or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

* * * * * *

STATEMENT

This action was instituted by a customer against a securities firm to recover damages, under the civil liabilities provisions of Section 12(2) of the Securities Act of 1933, for alleged misrepresentations in the sale of securities. Petitioner, the customer, charged in his complaint that, on or about January 17, 1951, he was induced by the New York securities firm of Hayden, Stone and Co. to purchase 1,600 shares of the common stock of Air Associates, Inc., for $29,517.24, by false representa-

tions that Air Associates had concluded a contract of merger with the Borg Warner Corporation pursuant to which Air Associates stock would be valued at $23.50 per share, or $6.00 per share over the current market price, and that bankers and large financial interests were buying up Air Associates stock for participation in said merger. He was not told, he alleges, that one Haven B. Page, a director of, and counsel for, Air Associates, was then selling his own Air Associates stock, including some or all of the shares which were sold to petitioner. Page was also named as a defendant. Petitioner resold the stock two weeks later at a loss of $3,888.88. Claiming that this loss was due to the firm's misrepresentations, he sought damages in that amount (R. 2-4).

Without answering the complaint, the firm moved for a stay pursuant to the Federal Arbitration Act, 9 U.S.C. § 3, and filed an affidavit which disclosed that on May 2, 1950, apparently in connection with an earlier unrelated transaction, and again on January 18, 1951, in connection with the instant sale, petitioner had signed a form "Margin Agreement" which the firm used in its dealings with its customers (R. 7-10). The form agreement is reproduced in relatively large type in six pages of the Transcript of the Record (pp. 11-16); but the document attached to the affidavit was a fine-print form, approximately 8½ by 11 inches, containing on one side of the sheet numerous pro-

visions respecting the rights and liabilities of the parties. A photocopy of the executed form is attached to this brief as an Appendix. There is no indication in the record that the various provisions of the agreement were actually read by the petitioner, or explained to him, before his signature was obtained. The stated consideration for his agreement was simply the opening and maintenance of an account with the firm.

The seventeenth paragraph of this fine-print form contains the following provisions for compulsory arbitration (R. 16, 22):

> Any controversy arising between us under this contract shall be determined by arbitration pursuant to the Arbitration Law of the State of New York, and under the rules of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or of the American Arbitration Association, or of the Arbitration Committee of the New York Stock Exchange or such other Exchange as may have jurisdiction over the matter in dispute, as I may elect. Any arbitration hereunder shall be before at least three arbitrators.

Another provision states that all transactions effected on the customer's behalf are subject to the constitutions, rules, customs and practices of the exchanges or markets where executed and of their

respective clearing houses, and to "the provisions of the Securities Exchange Act of 1934 and present and future acts amendatory thereof or supplemental thereto", and to applicable rules and regulations of the Securities and Exchange Commission (R. 11, 17).

Elsewhere in the fine-print form is a paragraph purporting to exculpate the firm and its members from liability for any misrepresentations made by them, or by their agents or employees, in the sale or purchase of securities (R. 14, 20).

The contract for the sale of the stock was a separate agreement (R. 26).

District Judge Goddard denied the motion for a stay pending arbitration. The arbitration agreement obtained by respondents "as a preliminary to the purchase of stock," he ruled, conflicted with the Securities Act of 1933 in attempting to deprive petitioner of the advantageous court remedy which Congress intended to afford a defrauded purchaser under Section 12(2) of that Act. Moreover, he held, it amounted to a waiver of compliance with the statute and was therefore rendered void by Section 14 of the Act (R. 23-32).

A divided Court of Appeals reversed the order of the District Court (R. 40-52). The majority of the court (Judges Swan and Chase) observed that the "question is not free from doubt" (R. 49), and described the district judge's opinion as "carefully reasoned" (R. 43) and one which "presents a

strong argument against the conclusion we have reached" (R. 49). It concluded, however, that the Securities Act of 1933 did not prohibit a securities firm from obtaining a pre-sale or pre-controversy agreement for the arbitration of any future cause of action, including the statutory cause of action for fraudulent misrepresentation, which a customer may later have reason to assert. The majority held, accordingly, that the stay provisions of the Federal Arbitration Act (9 U.S.C. § 3) were applicable (R. 41-49).

Judge Clark wrote a dissenting opinion in which he expressed the view that, under the ruling of the majority, "important rights under this notable first of a series of famous Acts for the benefit of the investing public [would] be capable of nullification by long fine-print restrictions of the broker's devising" (R. 52).

The Securities and Exchange Commission participated as *amicus curiae* in the proceedings in both courts below in opposition to the motion to stay the court action and compel arbitration, and also filed a brief in this Court in support of the petition for writ of certiorari. The Commission expresses no opinion with respect to any allegation of fact, or with respect to the substantive merits of the complaint.

SPECIFICATION OF ERRORS

While petitioner has assigned a sizable list of errors, the interest of the Commission as *amicus curiae* extends only to the following:

The majority of the Court of Appeals erred—

(1) In holding that the pre-sale agreement for compulsory arbitration is valid and enforceable against the petitioner customer in a subsequent action for fraudulent misrepresentation in the sale of securities brought against the respondent securities firm pursuant to Section 12(2) of the Securities Act of 1933; and, consequently,

(2) In reversing the order of the District Court which denied respondents' motion for a stay pending arbitration.

SUMMARY OF ARGUMENT

The decision below permits a securities firm—through the device of a fine-print pre-transaction agreement containing a compulsory arbitration clause—to deprive a customer of the special court remedy which Section 12(2) of the Securities Act of 1933 was intended to accord him in the event of a fraudulent sale. The arbitration provision should be held invalid because of conflict with the policy of Congress, and as an attempted waiver of the customer's statutory rights prohibited by Section 14 of that Act.

I.

The many litigation advantages provided by Section 12(2) were designed to afford a defrauded customer a simple and effective court remedy which he did not have at common law. The legislative history of Section 12(2), and the provisions of Section 14 invalidating waivers of compliance with the statute, make it clear that Congress intended this remedy to be available to a customer who seeks relief from a fraudulent sale. The view of the majority below that Section 14 only invalidates waivers of the "prohibitive provisions" of the Act, and not the "means of enforcement provisions", conflicts with the purpose and text of the statute, and imposes limitations upon broad statutory anti-waiver provisions which this Court has already rejected. Apart from the express anti-waiver provision, public policy precludes recognition of a stipulation limiting or preventing access to a court where, as here, the statutory rights, although conferred on a private party, are affected with a public interest.

The Federal Arbitration Act does not require recognition of the pre-sale stipulation; for that Act only pertains to controversies which are properly "referable to arbitration". The statute is inapplicable where public policy requires that the particular claim be decided by a court, or that the claimant have access to a court.

II.

The customer's statutory rights are not preserved in arbitration. The arbitration process is primarily suited for commercial disputes which often can best be resolved by businessmen on the basis of their own knowledge and experience, and without reference to technical rules of law. The Securities Act, on the other hand, was not intended to reflect business attitude toward the responsibilities of professionals in the securities field to their customers. The arbitrators would be appointed from an industry selected panel, and would ordinarily be laymen who could be expected to adjudicate the customer's claim without reference to the legal requirements of the Securities Act.

The suggestion of the majority below that it has safeguarded the customer's statutory rights by construing the pre-sale stipulation to require the arbitrators to apply the Securities Act rests upon a questionable legal premise and, in any event, is unrealistic. We know of no authority for the thesis of the majority below that the arbitrators can be compelled to abandon their normal functions and act like judges learned in the law through court review of an award to ascertain whether rules of legal procedure, evidence, and substantive law have been correctly applied. The suggested simulated court trial, moreover, conflicts with the various arbitration association rules adopted by the pre-

sale stipulation. The suggestion ignores the realities of the situation. The arbitrators will act according to their business background; and unless they volunteer explanations, which are not mandatory, there is no way of checking the steps by which they reach their conclusion.

III.

The assumption of the majority below that a post-controversy stipulation would be unobjectionable, and that a pre-sale stipulation presents no different question, overlooks important dissimilarities in relevant statutory policy. Election of a particular remedy or course of action, after a claim has been asserted, may possibly be consistent with the statutory scheme. A post-controversy stipulation for arbitration, if valid, would merely fall into the category of other post-controversy elections which may limit a plaintiff's course of action —*e.g.*, waiver of a jury trial, or acceptance of a compromise settlement. On the other hand, the pre-sale stipulation is designed to, and does, strip the customer of his statutory rights before there is any occasion for a choice of remedy.

ARGUMENT

I. Congress Intended, and Public Policy Requires, That the Special Judicial Remedy Afforded by Section 12(2) of the Securities Act be Available to a Customer Seeking Relief From a Fraudulent Sale.

(a) Section 12(2) Affords the Customer A More Effective Judicial Remedy Than That Accorded by Common Law.

A major purpose of the Securities Act of 1933 is to afford purchasers of securities more effective remedies for misrepresentation and non-disclosure than were accorded at common law.[3] Congress conceived that securities are "intricate merchandise",[4] and that the public interest demanded legislation which would recognize the gross inequality of bargaining power between the professionals in the securities business and the average investor. The Act was passed in response to a Presidential message urging that there be added to the ancient rule of *caveat emptor* the further doctrine "let the seller also beware",[5] and the reports of the Congressional committees recognize this important goal.[6] At the same time, deliberate consideration was given to avoidance of undue risks from errors of judgment by those engaged in the securities industry. Section 12(2) and the other civil liabili-

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[3] The common law remedies, however, were preserved by Section 16 of the Act, 15 U.S.C. § 77p.

[4] H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 8.

[5] *Id.* p. 2.

[6] *Ibid.*; S. Rep. No. 47, 73d Cong., 1st Sess. (1933), pp. 6-7.

tics provisions of the Securities Act must be read in this context.[7]

Under Section 12(2), the plaintiff is not required to prove *scienter* as he must at common law. On the contrary, the burden of proof is shifted to the defendant seller who must prove "that he did not know, and in the exercise of reasonable care could not have known of [the] untruth or omission." The legislative history discloses that Congress recognized that, as a practical matter, if more than mere "paper liability" was to be imposed upon fraudulent vendors of securities, "it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission" on the seller. H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 9.[8] "To impose a lesser responsibility," it was felt, "would nullify the purposes of

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[7] For a comprehensive discussion, see Loss, *Securities Regulation* (1951), pp. 996-1029.

[8] "The provisions * * * are indispensable to make the buyer's remedies * * * practically effective. Every lawyer knows that with all the facts in the control of the defendant it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of the defendant." *Ibid.*

"The committee has deemed this shift in the burden of proof as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements or the failure of the seller to exercise reasonable care are matters in regard to which the seller may readily testify, but in regard to which the buyer is seldom in a position to give convincing proof." *Id.*, pp. 23-24.

this legislation." *Id.*, p. 10[9] In 1934, when in response to industry criticism Congress enacted some alleviating amendments with respect to Section 11 (civil liabilities on account of material misrepresentations or omissions in registration statements), it left Section 12(2) untouched.[10]

The statute also affords the defrauded purchaser a broad choice of forum. He may sue in any court of competent jurisdiction—federal or state. If he sues in a state court, the action cannot be removed to a federal court; and if he elects to sue in a federal court he has a broad choice of venue, with the

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[9] That such a shift in the burden of proof is not a mere matter of procedure, but goes to the very substance of the statutory right conferred, see *Garrett* v. *Moore-McCormack Co., Inc.*, 317 U.S. 239. That case involved an action by an injured seaman under the Jones Act for damages, and for maintenance and cure, which had been brought in a Pennsylvania state court. By way of defense, the shipowner produced a release executed by the seaman. The Pennsylvania court applied state law in holding that the seaman had not met the burden of proof required to invalidate the release. In reversing that holding, this Court found that the seaman had not been given "the full benefit of federal law" (*id.*, 243). "The right of the petitioner to be free from the burden of proof imposed by the Pennsylvania local rule," it stated, "inhered in his cause of action," and "was a part of the very substance of his claim" (*id.*, 249).

[10] See Loss, *Securities Regulation* (1951), pp. 1014-1018. The advantage of the Section 12(2) remedy over the common law action for fraud and deceit is illustrated by *Murphy* v. *Cady*, 30 F. Supp. 466 (D. Maine), affirmed, 113 F. 2d 988 (C.A. 1) certiorari denied, 311 U. S. 705, where the court dismissed the common law count of the compiaint but sustained the statutory action on the same allegations of fact.

privilege of nation-wide service of process, and he need not comply with the $3,000.00 requirement of diversity cases. See Section 22(a).

(b) The Pre-sale Attempt to Deprive the Customer of His Section 12(2) Remedy Conflicts With the Purpose of the Statute, and Is Rendered Void by the Anti-waiver Provisions of Section 14.

That Congress intended this advantageous judicial remedy to be available to a customer seeking relief from a fraudulent sale, irrespective of private agreement to the contrary, is shown by the aforementioned legislative history, and by the anti-waiver provisions of Section 14 of the Act. The latter expressly state that any "stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title * * * shall be void."[11] Under the instant stipulation for arbitration, exacted at the initiation of the customer's dealings with the securities firm, the customer waives his right, in the event of a fraudulent sale, to the special court remedy provided by Section 12(2) and the statutory choice of

[11] In enacting Section 14 Congress had the benefit of English experience in the securities field. Prior to the Companies Act of 1900, the English courts had honored stipulations binding securities purchasers to waive statutory liabilities so long as the stipulations were not too "tricky". *Greenwood* v. *Leather Shod Wheel Co.* [1900] 1 Ch. 421 (C.A.); *Cackett* v. *Keswick* [1902] 2 Ch. 456 (C.A.). For the past half-century, however, the English Companies Act has contained a broad non-waiver provision. See Loss, *Securities Regulation* (1951), pp. 1074-1077.

forum. We show below, in Point II, that arbitration does not assure the customer his statutory rights. The stipulation, in our opinion, involves to a very material degree a waiver of "compliance" with the statute.

The majority below, however, expressed the view that it was "far from clear that the words 'waive compliance with' refer to anything more than the mandatory or prohibitive provisions of the Act." It observed: "The means of enforcement provisions, on the other hand, seem clearly permissive, not requiring compliance" (R. 47). Section 14, of course, refers to "any provision of" the Act. To construe Section 14 as voiding only attempted waivers of the substantive prohibitions of the Act, such as those against fraud and misrepresentation, rather than the remedial provisions, runs counter to the express language of the section as well as to the evident purpose of the statute. Moreover, to the extent that enforcement of such substantive requirements is dependent upon the effectiveness of the private remedies afforded, the view of the majority below can only tend to undermine compliance with those substantive provisions as well. See H. Rep. No. 85, 73d Cong., 1st Sess. (1933), pp. 9-10, *supra*, pp. 16-17. Thus, if a customer, in advance of his dealings with a securities firm, may be induced to contract away all of his remedial rights under the Act, the obvious consequence is to render nugatory those remedies and to eliminate an im-

portant sanction relied upon by Congress to enforce compliance with the statute. The majority below clearly indicated that had the pre-sale stipulation provided for the waiver of all of the customer's remedial rights, it would have regarded this as a waiver of compliance within the meaning of Section 14. The decision below, accordingly, must rest on the untenable thesis that it is permissible to obtain a waiver of some of the customer's remedial rights, but not all of them. However, if the language "waive compliance with any provision of this title" is not construed to cover the waiver of a remedial right, as such, there appears no logical stopping point short of the complete deprivation of a remedy. On the other hand, if the quoted language does cover remedial rights, it necessarily preserves all of them, and forbids any of them to be bargained away in advance of the transaction giving rise to the customer's claim.

In any event, the kind of distinction made by the majority below has already been rejected by this Court. In *Boyd* v. *Grand Trunk Western Railroad Co.*, 338 U.S. 263, the Court held invalid a stipulation restricting an employee's choice of venue in an action under the Federal Employers' Liability Act (45 U.S.C. § 51). Section 6 of that Act (45 U.S.C. § 56) permits suit in any one of several localities, including any district in which the defendant may be doing business. Like the stipulation in the instant case which purports to

deprive the customer of his choice of a court remedy, including the right to a jury trial, and to relegate him to a proceeding before arbitrators appointed from an industry selected panel, the stipulation in the *Boyd* case would have deprived the railroad employee of his choice to sue the company wherever it was doing business, including suit in one of several large cities where jury verdicts might be higher, and would have limited him to an action in the locality where he resided or was injured. Section 5 of that statute (45 U.S.C. § 55) provides that any contract or device "to enable any common carrier to exempt itself from any liability created by this Act, shall to that extent be void * * *." The Court held that the "right to select the forum" is a "substantial right", and that the agreement which sought to restrict that choice "would thwart the express purpose of" the statute (338 U. S., at 266). See also the earlier case of *Krenger* v. *Pennsylvania Railroad Co.*, 174 F. 2d 556, certiorari denied, 338 U. S. 866, decided by the Court of Appeals for the Second Circuit, in which Judge Clark concluded that the term "liability", as used in the anti-waiver provisions of the Federal Employers' Liability Act, was not limited to the carrier's ultimate obligation to pay damages, but included the "liability to be sued, *i.e.*, to have its legal relations changed—adversely—in any one of several jurisdictions" (174 F. 2d, at 559). Restriction of the employee's choice of

venue, therefore, was viewed as an attempt to obtain exemption from liability for suit "except under the favoring conditions of a single chosen jurisdiction" (*ibid.*). In *Ackerly* v. *New York Central Railroad Co.*, 168 F. 2d 812, also decided before the *Boyd* case, the Court of Appeals for the Sixth Circuit had adopted a similar view. Rejecting the railroad's contention that its liability "is in no way affected by the place or forum of trial", Judge Allen stated that it "was liable under § 6 of the Act to be sued in any one of three jurisdictions" and that, accordingly, "the venue provision (was) an inherent part of the employer's liability" (168 F. 2d, at 814-815). The anti-waiver language of the Securities Act of 1933, is, if anything, broader than that of the Federal Employers' Liability Act; for it renders void waiver of "compliance with any provision of" the Act. There is no comparable basis under the Securities Act for the contention, which was made under the Federal Employers' Liability Act but rejected by this Court in the *Boyd* case, that Congress intended only to prohibit a waiver of the substantive liability for damages.

The majority below also concluded that Congress would have included in Section 14 of the Securities Act a specific prohibition against arbitration had it intended that section to have such broad coverage (R. 51). Congress saw fit, however, to cover the matter of waivers by a single broadly worded prohibition, as another panel of judges of

the Court of Appeals previously recognized (*Kaiser-Frazer Corp.* v. *Otis & Co.*, 195 F. 2d 838, 843, n. 8, certiorari denied, 344 U. S. 856), rather than by the particularization of specific types of waivers. *Cf. Jefferson Lake Sulphur Co.* v. *Walet*, 104 F. Supp. 20 (E.D. La.), affirmed, *Walet* v. *Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (C.A. 5), petition for certiorari filed June 24, 1953, No. 140.[12] See also *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350.

(c) Apart from Section 14, Public Policy Precludes Enforcement of the Pre-Sale Stipulation Since the Section 12(2) Remedy is Affected With a Public Interest.

Wholly apart from the inclusion of an express anti-waiver provision in a statute, public policy prohibits the recognition and enforcement of stipulations limiting or preventing access to the courts where the statutory rights involved, although conferred on a private party, are affected with a public interest. *Brooklyn Savings Bank* v. *O'Neil*, 324 U. S. 697; *Ackerly* v. *New York Central Railroad Co.*, 168 F. 2d 812 (C.A. 6). In the *Brooklyn Savings Bank* case, this Court declared invalid a release waiving an employee's right to liquidated damages under the Fair Labor Standards Act. The

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[12] The same anti-waiver language in Section 29(a) of the companion Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a), was held in that case to make it "crystal clear" that any waiver of the right of a corporation to maintain an action under Section 16(b) of that statute, 15 U.S.C. § 78p(b), to recover the "short term" trading profits of a corporate insider, would be void (104 F. Supp., at 23-24).

liquidated damages provided by that statute were intended to compensate the employee for injury resulting from the improper retention of his pay which might be too difficult to estimate or prove. Underlying the Court's decision was the public interest which the statute sought to further—*viz.*, alleviation of "the unequal bargaining power as between employer and employee" which often resulted in employment agreements detrimental to the "national health and efficiency" and to the "free movement of goods in interstate commerce" (*id.*, 706-7). The rights given the employee were deemed to be of a "private-public character" related in purpose to, and supplementing the criminal and injunctive provisions enforced by the Government (*id.*, 709). Knowledge by the employer that he cannot escape his statutory liability by taking advantage of the inferior bargaining position of the employee, said Mr. Justice Reed, "tends to insure compliance in the first place" (*id.*, 710). The Court placed little significance upon the fact that an express anti-waiver provision had been eliminated from a predecessor bill, or upon the further fact that various other federal statutes authorizing employees to sue for wages and damages contain specific anti-waiver provisions. The absence of such a provision, Mr. Justice Reed stated, does not prevent the Court from invalidating waivers "where the legislative

policy would be thwarted by permitting such contracts" (*id.*, 713).[13]

As previously shown, the special court remedy which Section 12(2) of the Securities Act affords a defrauded purchaser of securities is similarly affected with a public interest. A principal purpose of the statute was to curb the "wanton misdirection of the capital resources of the Nation" [14] which had resulted in large measure from sales of securities to the public without adequate disclosures of the relevant facts and frequently by positive misrepresentations. Section 12(2) and other provisions of the statute were designed to alleviate the existing gross inequalities between the professionals in the securities business and the average investor. Like the Federal Employers' Liability Act, enforcement is divided between the government and the injured investor. The special court remedies for rescission and damages afforded the latter serve to give the individual redress and, by their very existence, also act as a deterrent to violation of the statute, thereby supplementing the public enforcement functions of the Commission. Under this Court's ruling in the *Brooklyn Sav-*

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[13] See also *W. J. McCahan Sugar Refining and Molasses Co.* v. *Stoffel*, 41 F. 2d 651 (C.A. 3), in which an agreement that an injured seaman's claim would be governed by the Pennsylvania Workmen's Compensation Law was held invalid as against public policy and, accordingly, no bar to the more advantageous suit under the Jones Act.

[14] H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 3.

ings Bank case, circumvention of the investor's statutory remedies, so charged and colored with the public interest, cannot be sanctioned even apart from the express anti-waiver provisions of Section 14.

(d) Recognition of the Pre-Sale Stipulation Is Not Required by the Federal Arbitration Act.

The existence of the Federal Arbitration Act at the time of the passage of the Securities Act provides no basis for doubt that Congress intended that the Section 12(2) court remedy be an available choice of every customer who finds that he has been defrauded. The arbitration statute is applicable only to controversies which are properly "referable to arbitration". Where, as a matter of public policy, the dispute ought to be handled by the courts or where the claimant ought at least to have access to the courts, the controversy does not come within the intended purview of the arbitration statute. The applicable public policy, of course, may be determined by the courts or by the legislature.[15]

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[15] The fact that the cause of action asserted may be statutory in origin, of course, does not necessarily mean that public policy forbids arbitration. Agreements to arbitrate claims under the Miller Act and Fair Labor Standards Act of 1938, for example, have been regarded as presenting no conflict with the policies of those statutes. See *Agostini Bros. Building Corp.* v. *United States*, 142 F. 2d 854 (C.A. 4); *Watkins* v. *Hudson Coal Co.*, 151 F. 2d 311 (C.A. 3), certiorari denied, 327 U. S. 777; *Donahue* v. *Susquehanna Col-*

In *Zip Mfg. Co.* v. *Pep Mfg. Co.*, 44 F. 2d 184 (D. Del.), a case under the federal arbitration statute, it was held that arbitration is not suitable for resolving a controversy involving the validity of a patent or the question of infringement. In *Kingswood Management Corp.* v. *Salzman*, 272 App. Div. 328, 70 N.Y.S. 2d 692, the New York arbitration law, upon which the federal statute was patterned,[16] was held inapplicable to a controversy involving an attorney's fee in a treble damages suit under the Federal Emergency Price Control Act.[17] In *Application of Diamond*, 80 N.Y.S. 2d 465, 467 (Sup. Ct.), affirmed, 274 App. Div. 762, 79 N.Y.S. 2d 924, a motion to stay a stockholder's derivative action and to require the claim to be resolved in an arbitration proceeding was denied on the ground, *inter alia*, that if the arbitration agreement covered the particular issues there involved it "would be unenforceable as against public policy". In *Application of Cohen*, 183

lieries Co., 138 F. 2d 3 (C.A. 3). The arbitrators' task in these cases was largely confined to making the necessary computations to ascertain amounts due the claimants. In the *Donahue* case the court agreed that arbitration would have been precluded had the legislative policy of the Fair Labor Standards Act been inconsistent therewith (138 F. 2d, at 6).

[16] *Zip Mfg. Co.* v. *Pep Mfg. Co.*, 44 F. 2d 184, 185 (D. Del).

[17] The Court stated (70 N.Y.S. 2d, at 693):

"The Emergency Price Control Act was adopted from urgent reasons of public policy which the Congress did not intend to turn over to private arbitrators to administer."

Misc. 1034, 52 N.Y.S. 2d 671 (Sup. Ct.), affirmed, 269 App. Div. 663, 53 N.Y.S. 2d 467,[18] a stay pending arbitration was denied in a proceeding to dissolve a closed corporation because of disagreement of the parties. *Cf.* also, *Lumsden* v. *Lumsden Bros. & Taylor, Inc.*, 242 App. Div. 852, 275 N.Y. Supp. 221. The New York arbitration statute has also been held inapplicable in other instances where it was determined that public policy required that the matter be subjected to judicial surveillance. Thus, arbitration has been deemed inappropriate as respects the custody of children and rights of visitation, *Hill* v. *Hill*, 199 Misc. 1035, 104 N.Y.S. 2d 755 (Sup. Ct.), and, as respects the distribution of a decedent's estate, *Swislocki* v. *Spiewak*, 273 App. Div. 768, 75 N.Y.S. 2d 147. See also *The Quarrington Court*, 102 F. 2d 916 (C.A. 2), certiorari denied, *sub nom. Court Line, Ltd.* v. *Isthmian S.S. Co.*, 307 U.S. 645, where it was held that the federal statute did not authorize arbitration of one of several claims subject to a limitation proceeding in admiralty.

It may be relevant to observe, also, that the more elaborate English arbitration statute now in effect contains a provision which expressly empowers the court to disregard an agreement for arbitration where, as in the instant case, an issue of fraud

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[18] Leave to appeal denied, 269 App. Div. 690, 54 N.Y.S. 2d 389, 294 N.Y. 640, 61 N. E. 2d 459.

is to be resolved.[19] Even before that provision, however, the English courts had regarded fraud claims as generally unfit for arbitration.[20] The suggestion of the majority below that its decision is in harmony with the English law (R. 48, n. 9), accordingly, would appear to be erroneous. See also pp. 36-38, *infra*.

We know of no prior precedent for permitting the waiver, through an arbitration agreement, of the statutory remedies provided in the Securities Act of 1933. Neither of the two cases in the securities field relied upon by respondents in the court below, and in which arbitration was required, involved an action under the federal securities statutes; and both cases presented essentially commercial disputes. One of them, *Parry* v. *Bache*, 125

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[19] Section 24(2) of the English Arbitration Statute of 1950 (14 Geo. VI, c. 27) provides:

"Where an agreement between any parties provides that disputes which may arise in the future between them shall be referred to arbitration, and a dispute which so arises involves the question whether any such party has been guilty of fraud, the High Court shall, so far as may be necessary to enable that question to be determined by the High Court, have power to order that the agreement shall cease to have effect and power to give leave to revoke the authority of any arbitrator or umpire appointed by or by virtue of the agreement."

[20] *Wallis* v. *Hirsch*, (1856) 26 L.J.C.P. 72, 73 (Cockburn, C. J.: "The plaintiffs allege that a gross fraud has been practised on them; and we do not think that is a proper question to be referred to two brokers."); *Barnes* v. *Youngs*, [1898] 1 Ch. 414, 419; *Green* v. *Howell*, [1910] 1 Ch. 495, 511 (C.A.). See also *Workman* v. *Belfast Harbour Commrs.*, [1899] 2 Ir. R. 234, 245 (Q.B. Div.).

F. 2d 493 (C.A. 5), was an action for an accounting with reference to securities which defendant was authorized to buy and sell on behalf of the plaintiff; the other *Newburger* v. *Lubell*, 257 N.Y. 213, 177 N.E. 424, decided prior to the Securities Act, involved the propriety of a broker's action in closing out a customer's account. [21]

II. Arbitration Cannot Assure the Customer His Statutory Rights.

The district court and Judge Clark dissenting in the court below correctly pointed out that arbitration cannot assure a customer that his statutory rights will be safeguarded. The advantages of arbitration as a simple and speedy method of disposing of commercial disputes which can satisfactorily, and often best, be determined by persons expert in the particular business in light of their own experience and knowledge, and without reference to technical rules of law and procedure, provide the

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[21] In the court below we called attention to two unreported district court decisions which enforced arbitration agreements involving claims arising out of alleged violations of the margin rules promulgated by the Federal Reserve Board under Section 7(a) of the Securities Exchange Act of 1934, 5 U.S.C. § 78g(a). *Appel* v. *Levine*, S.D. N.Y., Civil Action No. 46-662, Sept. 20, 1948 (Clancy, J.), and *O'Connell* v. *Mallory*, S.D.N.Y., Civ. Action No. 47-164, March 22, 1949 (Kaufman, J.), CCH Fed. Sec. L. Rep. § 90, 445. There was no contention or discussion in either case as to the validity of the arbitration agreement, and the question which might have been presented would in any event be dissimilar because of the differences in statutory context. The majority below did not deem these decisions sufficiently relevant to be cited.

basis for the rapid growth of these nonjudicial tribunals in recent years.[22] In the words of leading proponents—

> It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact—quantity, quality, time of delivery, compliance with terms of payment, excuses for nonperformance, and the like. It has a place also in the determination of the simpler questions of law—the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions

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[22] Compare Judge Frank's observation in his recent book, *Courts on Trial* (1949), p. 377:

"Since, generally speaking, arbitrators are not bound to apply legal rules, the fact that, increasingly, businessmen resort to arbitration throws some doubt on the conventional notion * * * that precise legal rules are primarily needed in the realm of business, that they supply a certainty and stability which men of business must have, that 'the commercial world' demands such rules 'because no one * * * engages in complex commercial undertakings trusting to' decisions resting on uncertain exercise of 'discretion'. Paradoxically, arbitration, with its freedom to disregard the legal rules, seems to function best in dealing with business disputes and not with those disputes which arise from angry personal feelings—where, on the whole, legal certainty has been said to be as of far less importance. One suggested explanation of this paradox is that businessmen who arbitrate have less interest in the legal rules than in the customs of their trade, which they feel will receive more attention from arbitrators acquainted with those trade customs than from the courts."

of law which are complementary to the questions of fact which we have just mentioned.[23]

In the securities field, it has been employed as a means of settling a variety of technical and business disputes—*e.g.*, controversies relating to the handling of customers' orders and securities, disputes between broker-dealers, disputes between partners in securities firms, and so forth.[24]

But even the proponents of arbitration have cautioned that arbitration should not be regarded as a desirable substitute for a court trial in many types of cases. See *Handbook and Guide to Commercial Arbitration,* issued by the Chamber of Commerce of the State of New York (1932), pp. 4-6. Where expertise in the law, rather than experience in a particular phase of business, is essential to a proper determination of the particular controversy, the arbitration process may be fraught with danger.[25] "The power to disregard rules of procedure and evidence and of law, which is one of the great advantages of proper arbitra-

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[23] Cohen and Dayton, *The New Federal Arbitration Law,* 12 Va. L. Rev. 265, 281 (1926), quoted with approval in *Zip Mfg. Co.* v. *Pep Mfg. Co.*, 44 F. 2d 184, 186 (D. Del.).

[24] See Jacquin, *Arbitration on the Big Board,* Arbitration in Action, vol. 1, no. 2, p. 5 (1943); Stone, *Justice Weighs Bulls and Bears,* Investment Dealers' Digest, Jan. 28, 1952, p. 20. See also pp. 29-30, *supra.*

[25] *Cf.* Judge Frank's remarks in *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978, at 987, n. 32 (C.A. 2).

tion, is capable of becoming an instrument of abuse and oppression in such hands (i.e., in the hands of laymen)—just as a motor car driven by an unskilled * * * driver can do great damage." *Id.*, p. 6.

The Securities Act of 1933 was not intended to reflect business custom as to the responsibility of professionals in the securities business with repect to representations made to customers. Rather, it was designed primarily to protect the less informed members of the public against the professionals, in the light of past experience which indicated that misrepresentations not infrequently were made and that under pre-existing law it was extremely difficult for the customer to obtain adequate redress. To that end, the 1933 Act affords the customer who believes he has been sold securities through misrepresentation a court remedy in which the seller is deprived of important legal advantages which he had at common law, and, most significantly, is required to prove his innocence once the customer establishes the misrepresentation. In addition, the statute gives the customer a choice between suing in a federal court or in a state court, as well as a liberal choice of venue. Such provisions for investor protection become quite innocuous if the professional may deprive the customer of these rights by obtaining, in advance of any controversy, the customer's signature to a fineprint agreement purporting to take away from him his judicial remedies under the statute, and relegating

him to a proceeding before an industry selected board of arbitrators.[26]

We do not believe that it was intended that the court remedy provided by the statute could be rendered unavailable to a customer by a form agreement, prepared by the seller's attorney, whether or not the seller or his attorney deemed the substitute procedure of arbitration more advantageous for the seller, or more advantageous for both the seller and the customer. For that reason, we regard as irrelevant respondents' argument that arbitration is as good for the customer as is court litigation. Clearly it is different, or there would be no point in exacting the stipulation to arbitrate; and respondents' present insistence upon arbitration indicates that they consider the differences advantageous to them. Among the aspects of the court remedy provided by the statute, which are not available to the customer in arbitration, are the rights to have questions of law decided by a judge subject to appellate review, to have issues of fact established by competent and relevant evidence, and to have such issues determined by a jury unless a jury trial is waived. In arbitration, however, as Judge Learned Hand has stated, the parties "must content themselves with looser approximations to the enforcement of their

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[26] See *e.g.*, Art. VIII, Sections 4 and 6, of the Constitution, and Rule 754 of the Rules of the Board of Governors, of the New York Stock Exchange.

rights than those that the law accords them, when they resort to its machinery." *American Almond Products Co.* v. *Consolidated Pecan Sales Co., Inc.*, 144 F. 2d 448, 451 (C.A. 2).[27] As previously indicated, the arbitrators would ordinarily be laymen who would hear and decide the customer's claim without reference to technical rules of law and procedure. There is no assurance that the arbitrators would or could correctly apply the rules of procedure, the principles of evidence, the substantive law of fraud and misrepresentation, the statutory burden of proof, and the correct measure of damages. There is no assurance, moreover, that lay arbitrators would not be influenced in some degree by the exculpatory provision of the margin agreement whose invalidity was recognized by the court below (R. 45, 48). Finally, as Judge Clark observed in his dissent, it is improbable that industry arbitrators would give "the customer that objective and sympathetic consideration of his claim which is envisaged by the Securities Act" (R. 50).

The majority of the Court of Appeals was not unconcerned with these dangers. It felt, however, that they would be avoided in this case because (1) it construed the margin agreement to require, by implication, that the arbitrators apply the provi-

[27] To the same effect, see Judge Augustus N. Hand's remarks in *In re Canadian Gulf Line, Ltd.*, 98 F. 2d 711, 714 (C.A. 2).

sions of the Securities Act of 1933, and (2) it considered that, therefore, a decision by the arbitrators not reached in conformity with Section 12(2) could be vacated by the court under Section 10 of the Federal Arbitration Act, 9 U.S.C. § 10 (R. 45-46, 48-49). A persuasive authority, it noted, was the English decisional law under which "even without such an express provision in the arbitration agreement, the arbitrators must decide 'according to the legal rights of the parties' ", citing a number of English cases (R. 48, n. 9). The majority below, however, was apparently unaware of the provision in the English Arbitration Act which enables the court to render judgment on any question of law arising during the course of an arbitration proceeding, or on the legal correctness of an award or part of an award, upon a "special case" submitted by the arbitrator or directed by the court on application of a party.[28] The underlying rationale of the English arbitration statute is set forth in *Czarnikow* v. *Roth, Schmidt & Co.*, [1922] 2 K.B. 478 (C.A.), one of the cases cited by the majority below, holding invalid a provision in an arbitration agreement that questions of law arising in the course of the arbitration should be decided by the arbitrator. Lord Justice Scrutton stated (pp. 488-489):

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[28] Section 21 of the English Arbitration Act (14 Geo. VI, c. 27) codifying earlier statutes. See Russell, *Law of Arbitration* (15th ed., 1952), c. 12.

Arbitrators, unless expressly otherwise authorized, have to apply the laws of England. When they are persons untrained in law, and especially when as in this case they allow persons trained in law to address them on legal points, there is every probability of their going wrong, and for that reason Parliament has provided in the Arbitration Act that, not only may they ask the Courts for guidance and the solution of their legal problems in special cases stated at their own instance, but that the Courts may require them, even if unwilling, to state cases for the opinion of the Court on the application of a party to the arbitration if the Courts think it proper. This is done in order that the Courts may insure the proper administration of the law by inferior tribunals. In my view to allow English citizens to agree to exclude this safeguard for the administration of the law is contrary to public policy. * * * I am ready to go very far in ignoring technicalities and irregularities on the part of arbitrators, unless there is some real substance of error behind them, but I think commercial men will be making a great mistake if they ignore the importance of administering settled principles of law in commercial disputes, and trust to the judgment of business men, however experienced in business, based only on the facts of each particular case, and with

no knowledge of or guidance in the principles of law which must control the facts and which arbitrators must administer.

Unlike the English statute, the Federal Arbitration Act does not authorize a court to decide questions of law arising during the course of an arbitration proceeding,[20] or to ascertain whether the arbitrators correctly applied the law in reaching their award. The court review provisions of Section 10 of the federal statute, upon which the majority below relied, empower the court to vacate an award for "corruption, fraud, or undue means", "evident partiality ", "misconduct" in refusing postponements or in refusing to hear "pertinent and material" evidence, or where the arbitrators have "exceeded their powers".

The simulated court trial which the majority below suggested would be required as the result of its construction of the margin agreement runs counter to the basic purpose and concept of the arbitration process. We know of no authority in the Federal Arbitration Act or elsewhere which would empower a court to compel arbitrators to abandon their normal functions and conduct the equivalent of a court proceeding, assuming that

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[20] The House of Representatives' Report on the bill which became the Federal Arbitration Act noted that once the arbitration machinery is set in motion, "the arbitration proceeds without interference by the court". H. Rep. No. 96, 68th Cong., 1st Sess. (1924); p. 2.

they were able to do so. In support of its assumption that the failure of the arbitrators correctly to apply Section 12(2) would constitute a ground for vacating the award under Section 10 of the federal arbitration statute, the majority below cited but one case—*Evans* v. *Hudson Coal Co.*, 165 F. 2d 970 (C.A. 3). However, all that the Court of Appeals for the Third Circuit suggested in the *Evans* case was that an arbitration award based upon a wage formula in a collective bargaining contract which was clearly illegal under the Fair Labor Standards Act might be set aside.[30] An illegal provision, of course, cannot afford a basis for arbitration.[31] That court had concluded in earlier cases that there was nothing in the Fair Labor Standards Act which was inconsistent with the arbitration of claims under that statute (*Donahue* v. *Susquehanna Collieries Co.*, 138 F. 2d 3, 6), and that the "calculation of the amount of money to which * * * [an employee] may be entitled under the Act * * * is the kind of problem which is properly referable * * * to * * * an arbitrator" (*Watkins* v. *Hudson Coal Co.*, 151 F. 2d 311, 320, certiorari denied, 327 U.S. 777). In the *Evans* and

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[30] This is enunciated more clearly in *Watkins* v. *Hudson Coal Co.*, 151 F. 2d 311 (C.A. 3), certiorari denied, 327 U.S. 777, to which the court referred.

[31] *Loving & Evans* v. *Blick*, 204 P. 2d 23, 27 (Cal.); *In re Gale*, 176 Misc. 277, 27 N.Y.S. 2d 18, 21-23 (Sup. Ct.); *Pittsburg Const. Co.* v. *West Side Belt R. Co.*, 151 Fed. 125, 130 (C.C. W.D. Pa.).

Watkins cases, the court set forth the correct legal standard for the guidance of the arbitrators in making their mathematical computations—a task it regarded as appropriate for lay arbitrators.[32]

As previously indicated, nowhere in the review provisions of the federal arbitration statute does there appear to be any authority vested in the courts to compel arbitrators to act like judges learned in the law through review of the award to ascertain whether the rules of legal procedure, evidence, or substantive law have been correctly interpreted and applied. Moreover, the pronouncement of the majority below gives no consideration to the various arbitration associations' rules ex-

[32] Nor do the additional cases cited by respondents in their brief opposing the grant of certiorari (pp. 13-14) provide support for the suggestion of the majority below. Thus, *Campbell* v. *American Fabrics Co.*, 168 F. 2d 959 (C.A. 2), and *United Fuel Gas Co.* v. *Columbian Fuel Corp.*, 165 F. 2d 746 (C.A. 4), both involved objections that the arbitrators had disregarded express contract formulas for the valuation of property. In the latter case, the court found that the arbitrators had not misinterpreted the contract nor considered improper evidence, but observed that "had they done so, this would not vitiate the award" (165 F. 2d, at 751). *Springs Cotton Mills* v. *Buster Boy Suit Co., Inc.*, 275 App. Div. 196, 88 N.Y.S. 2d 295, affirmed, 300 N.Y. 586, 89 N.E. 2d 877, cited under the New York arbitration statute, merely suggests that the arbitrators may be restricted by contract to consideration of only such evidence as the parties may themselves produce. The court regarded it as "well settled," however, that the arbitrators could not be hampered by adherence to the "case and statutory law governing the prosecution of actions" (88 N.Y.S. 2d, at 298).

pressly adopted by the Margin Agreement with which the required simulated court trial would appear to conflict.[33]

While we assume that an award which expressly relied upon the invalid exculpatory clause in the Margin Agreement could be set aside for that reason alone,[34] as a practical matter the possibility of judicial review of an award suggested by the court below cannot enable the court to exercise supervision of the entire arbitration process so as to assure the customer the equivalent of a trial by a "court of competent jurisdiction", to which he is entitled under Section 12(2) of the Securities Act, including enforced adherence to the statutory shift in the burden of proof. The contrary assumption of the majority below appears to ignore the realities of the situation. As Judge Clark aptly stated in his dissent (R. 50-51)—

> The suggestion that perhaps the business arbitrators will be able or inclined to manipulate the burden of proof like lawyers and judges seems to me completely unreal. * * * The arbitrators will act according to their business background and there will be no way

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[33] Thus, the rules of the American Arbitration Association provide that "The Arbitrator shall be the judge of the relevancy and materiality of the evidence offered and conformity to legal rules of evidence shall not be necessary." Rule 30 of the Commercial Arbitration Rules.

[34] See n. 31, *supra*.

—unless they volunteer foolish explanations in their decision—of checking what they do.[35]

The suggestion concerning possible supervision of the whole arbitration process, moreover, appears inconsistent with the concept of the judicial function expressed by other courts of appeals,[36] and by the Court of Appeals for the Second Circuit itself in other cases,[37] so that it is not at all clear

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[35] The suggestion in the Harvard Law Review (66 Harv. L. Rev. 1326) that review of the arbitrators' application of the statutory burden of proof would probably be no less than review of a jury verdict, overlooks the power of a trial judge to direct a verdict or to set aside a verdict as contrary to the weight of the evidence—a power not possessed by a reviewing court under the Federal Arbitration Act as respects an arbitration award.

[36] See *e.g.*, *Donahue* v. *Susquehanna Collieries Co.*, 160 F. 2d 661, 664 (C.A. 3), (district judge may not "supervise and control" the arbitration proceeding by directing findings on specified questions); *United Fuel Gas Co.* v. *Columbian Fuel Corp.*, 165 F. 2d 746, 751 (C.A. 4), *supra*, n. 32.

[37] See *American Almond Products Co.* v. *Consolidated Pecan Sales Co., Inc.*, 144 F. 2d 448, 451 (award confirmed despite plaintiff's failure to submit evidence on amount of damages; arbitrators may have determined amount by own expert knowledge and experience; when parties choose to arbitrate "they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid"); *James Richardson & Sons, Ltd.* v. *W. E. Hedger Trans. Co.*, 98 F. 2d 55. 57, certiorari denied, 305 U.S. 657 (court has no "power to amend or overrule merely because of disagreement with matters of law or fact determined by the arbitrators"); *In re Canadian Gulf Line, Ltd.*, 98 F. 2d 711, 714 (arbitration tribunal's "extensive powers" are subject to "most restricted review"); *The Hartbridge*, 62 F. 2d 72, certiorari de-

that even the limited safeguards which the majority below suggests should be afforded through judicial supervision and review of the results of arbitration will be recognized elsewhere, or, for that matter, recognized in the court below when an award is actually challenged.

Instead of assuring the customer his statutory rights, including that of having the burden of proof shifted to the seller, the decision below imposes upon the customer the burden of proving, as a prerequisite to having an adverse award vacated, that the arbitrators did not comply with the requirements of the Securities Act.[38] This provides further evidence that the procedure sanctioned below is not an adequate substitute for the remedy afforded by the Securities Act. It illustrates, also, the lack of warrant for the majority's assumption that arbitration will be more "speedy" (R. 47);

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nied, 288 U.S. 601 (arbitrators' determination either as to law or facts is final, award confirmed where no showing of fraud, corruption, misconduct, or action in excess of arbitrators' powers). See also *Karppinen* v. *Karl Keifer Machine Co.*, 187 F. 2d 32, 34.

To the same effect, under the similar court review provisions of the New York arbitration statute (N.Y. Civil Practice Act, § 1466), see *Springs Cotton Mills* v. *Buster Boy Suit Co., Inc.*, 275 App. Div. 196, 88 N.Y. Supp. 2d 295, affirmed, 300 N.Y. 586, 89 N.E. 2d 877, *supra* n. 32. See also *Wilkins* v. *Allen*, 169 N.Y. 494, 496, 62 N.E. 575, 576 ("The award of an arbitrator cannot be set aside for mere errors of judgment, either as to the law or as to the facts".)

[38] *American Almond Products Co.* v. *Consolidated Pecan Sales Co., Inc.*, 144 F. 2d 448, 450 (C.A. 2).

for, as the dissent aptly stated, "no matter how time consuming may be the arbitration itself, [under the majority's view] it must necessarily be succeeded by lengthy judicial proceedings before the award is legally enforceable" (R. 51). The arbitration award might then very well become the "commencement, not the end, of [the] litigation".[39]

III. The Possibility of Valid Post-Controversy Agreements, Involving Different Statutory Considerations, Provides No Basis for Recognition of the Pre-Sale Stipulation.

The assumption of the majority below (R. 46-7) that the customer could enter into a binding stipulation to arbitrate his claim after an action has been instituted, and that a pre-sale stipulation presents no different question, overlooks important differences in statutory policy. Since the Act accords the defrauded customer an election between his statutory and common law remedies, and gives him also a choice of forum, it may perhaps be arguable that it might be consistent with the purpose of the statute if the customer were permitted to elect, after an action has been commenced, to have his claim for violation of his substantive rights determined by arbitration rather than by court action. *The Commission took no position on this question in the court below and we take none here.* We suggest merely that if post-

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[39] *Burchell* v. *Marsh*, 17 How. 344, 349.

controversy agreements to arbitrate are valid, they fall into the category of other post-controversy arrangements which may limit plaintiff's course of action, such as the decision to waive a jury trial, or perhaps to accept a compromise settlement of his claim. We submit, therefore, that the court below erred in assuming that there can be no distinction between a pre-controversy and a post-controversy stipulation. While we do not so argue at this time, we recognize the possibility that the grant of latitude for informed and reasonable post-controversy agreements may perhaps be consistent with the realistic effectuation of the purpose of Congress to afford the investor a choice of remedies.[40]

On the other hand, to uphold the pre-controversy stipulation enables the professional in the securities business to strip the investor of the protection of the statute. Contrary to the purpose of Congress, the decision below gives no recognition to the grossly unequal positions of the securities firm

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[40] The fact that the stipulation is entered into after the cause of action has been asserted, of course, cannot in itself give it validity. Thus, the stipulations which this Court held invalid in the *Boyd* and *Brooklyn Savings Bank* cases (pp. 20-21, 23-25, *supra*) were obtained after causes of action had been asserted. Determination of the validity or invalidity of a post-controversy stipulation would require consideration of the particular statutory policy applicable to the rights abandoned. Moreover, as Judge Learned Hand suggested in the *Krenger* case (174 F. 2d, at 562), it might be advisable in any event to withhold judicial sanction if it does not appear that the claimant had the benefit of independent counsel before signing the agreement.

and the average customer who, before effecting a purchase, is requested to sign a fine-print form agreement.[41] An analogy on this point is mentioned in Judge Clark's minority opinion—*viz.*, the decisions of this Court which invalidate, under the Federal Employers' Liability Act, releases obtained prior to an accident, but recognize them if fairly and reasonably made in settlement of an existing claim (R. 52).[42] As Judge Clark noted, however, the question as to when a post-controversy agreement may be valid is not now before this Court.

Recognition of the pre-sale stipulation runs counter to the basic philosophy of the Securities Act that the statutory disclosure requirements be complied with before the customer is in any way committed in a securities transaction (see Section

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[41] As District Judge Goddard observed, the average customer is unaware of his rights under the Securities Act and would not hesitate to sign what appears to him to be the "customary form" for opening an account with the securities firm (R. 28). The instant form, moreover, may lull an unsuspecting customer, who may happen to glance over it before signing, into a false sense of security. An early paragraph gives the impression that everything will be done in accordance with federal law—*viz.*, the Securities Exchange Act of 1934 and supplemental statutes. Later paragraphs, however, contain, *inter alia*, the broad exculpatory clause and the provision for compulsory arbitration.

[42] *Callen* v. *Penna. R. R.*, 332 U.S. 625, 631; *Boyd* v. *Grand Trunk Western R. Co.*, 338 U.S. 263, 266. See also *Krenger* v. *Pennsylvania Railroad Co.*, 174 F. 2d 556, 561 (C.A. 2), certiorari denied, 338 U.S. 866.

5, 15 U.S.C. § 77e). The instant stipulation, on the contrary, commits the customer in advance of any transaction to a waiver of important rights which would accrue to him as the result of the seller's failure to comply with the statute. While the stipulation here in question was exacted by a broker-dealer in connection with the opening of an account, the decision below may well suggest exaction of similar stipulations for arbitration by issuers and underwriters who desire to avoid lawsuits under the companion civil liability provisions of Section 11 of the Act, 15 U.S.C. § 77k, on account of misrepresentations or omissions in registration statements.

As the dissenting judge stated, commercial arbitration has been highly useful in providing a businessman's adjudication of a business dispute; but it would be "vastly unfortunate" if the presale stipulation exacted here "became usable as a device to blunt or break social legislation" (R. 50-51). Yet, it is such a device that the majority below has sanctioned.

CONCLUSION

The decision below renders capable of nullification important rights which Congress intended to afford public investors, and is in conflict with the Securities Act of 1933. It should be reversed.

Respectfully submitted,

ROBERT L. STERN,
Acting Solicitor General.

WILLIAM H. TIMBERS,
General Counsel,

ROGER S. FOSTER,
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Special Counsel,

GEORGE H. JAFFIN,
Attorney,

Securities and Exchange Commission.

October, 1953.

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APPENDIX

MARGIN AGREEMENT

2M 9 48
FORM 220

HAYDEN, STONE & CO.
25 Broad Street
New York, N. Y.

January 18, 1951 19

Dear Sirs: In consideration of your opening now or in the future or continuing an account or accounts in my name or for me for the purchase or sale of property, I agree with you and your successors as follows, all my relations and dealings with you being subject to this agreement:

The word "property" as used herein shall include shares of stock, certificates of shares of stock, scrip certificates, stock warrants or rights, and bonds, notes, debentures and other evidences of indebtedness whether secured or unsecured and the security therefor, and commodities and contracts for the future delivery of commodities and other securities of every kind and nature, and contracts for property, and all other property usually and customarily dealt in on Exchanges, Boards or Markets or by stock brokerage firms.

All transactions made by you or your agents for me are to be subject to the constitutions, rules, customs and practices of the exchanges or markets where executed and of their respective clearing houses and shall be subject to the provisions of the Securities Exchange Act of 1934 and present and future acts amendatory thereof or supplemental thereto, and to the rules and regulations of the Federal Securities and Exchange Commission and of the Federal Reserve Board insofar as they may be applicable, and shall also be subject to the provisions of the Commodity Exchange Act and present and future acts amendatory thereof or supplemental thereto, and to the rules and regulations of the Secretary of Agriculture insofar as they may be applicable. All orders for the purchase or sale of any property are given by me and executed with the distinct understanding that an actual purchase or sale is intended and that it is my intention and obligation in every case to deliver certificates or commodities to cover any and all of my sales and in the case of purchases to receive and pay for certificates or commodities and that I will do so upon your demand. In case you make a short sale of any property at my direction or in case I fail to deliver to you any property which you have sold at my direction, I authorize you to borrow the property necessary to enable you to make delivery to the purchaser and I agree to be responsible for the cost or loss you may thus incur, or the cost of otherwise obtaining the property if you are unable to borrow it. No settlement of any account for me may be made by me without all property in which my account is short being received by you and all property in which my account is long being paid for in full and the property then delivered, and you and your correspondents are hereby constituted agents of mine for the purpose of consummating all such transactions, and are authorized to make such advances and expend such moneys as may be required in respect thereof. When placing with you any sell order for short account I will designate it as such and hereby authorize you to mark such order as being "short", and when placing with you any order for long account I will designate it as such and hereby authorize you to mark such order as being "long". Any sell order which I shall designate as being for long account will be for securities then owned by me and if such securities are not then deliverable by you from any account of mine, the placing of such order shall constitute a representation by me that I will deliver such securities as soon as I can do so without undue inconvenience or expense.

Any order given you by me shall be binding upon me and my personal representatives until you have actual notice of my death, but my death and notice thereof shall not in any way affect your rights under this agreement to take any action which you could have taken if I had not died.

Subject to the provisions of applicable statutes and regulations thereunder, all property now or hereafter held or purchased by you for me shall be subject to a general lien for the payment of all liabilities of mine to you however and whenever arising, and you are hereby authorized without notice to me whenever you deem it advisable, from time to time to transfer interchangeably between any accounts I have with you any or all of the property so held, and without further notice to me and without regard to whether you have in your possession or subject to your control at the time thereof other property of the same kind and amount, in the usual course of business to pledge, repledge, hypothecate, rehypothecate (either for the amount due you from me or for a greater sum) and lend the same to yourselves as brokers or to others from time to time, separately or together with other property and you shall not be required to deliver to me the same property deposited or received but only property of the same kind and amount.

You may at any time demand that my account or accounts immediately be taken up and paid, and all amounts advanced and other balances due, with interest at the current rate, and all commissions fixed by the regulations and usages of the exchange or market where orders are executed shall be due and payable upon demand. I will at all times maintain margins for said accounts as from time to time required by you.

You may employ sub-brokers and shall be responsible only for reasonable care in their selection and may settle contracts and controversies according to the regulations and customs of the Exchange or Market where the orders are executed. You may deal with members of any Exchange known as specialists or known as odd lot dealers and in the execution of my orders they may act as sub-brokers for me and may also buy or sell the property for themselves as dealers on their own accounts.

Upon my death or failure to comply with any of the provisions hereof, or whenever you deem it necessary for your protection (it being understood that on transactions in securities when, as and if issued you are entitled to protection against your contingent liability pending the issue of the securities to the same extent as in purchases and sales of securities already issued and that you may purchase or sell odd lots on offer or bid without waiting for a round lot transaction) you are hereby authorized and empowered to cancel outstanding orders, sell, assign and deliver all or any part of the property or contracts for property held or carried for me and close out short sales by purchase upon any exchange or market or at any public or private sale at your option, all without demand for margin or notice of purchase or sale, which are expressly waived, and no specific demand or notice shall invalidate this waiver, and after deducting all costs and expenses of purchase or of

Account Name ILKO, Anthony MA

me shall be subject to a general lien for the payment of all liabilities of mine to you wherever and whenever arising, and you are hereby authorized without notice to me whenever you deem it advisable, from time to time to transfer interchangeably between any accounts I have with you any or all of the property so held, and without further notice to me and without regard to whether you have in your possession or subject to your control at the time thereof other property of the same kind and amount, in the usual course of business to pledge, repledge, hypothecate, rehypothecate (either for the amount due you from me or for a greater sum) and lend the same to yourselves as brokers or to others from time to time, separately or together with other property and you shall not be required to deliver to me the same property deposited or received but only property of the same kind and amount.

You may at any time demand that my account or accounts immediately be taken up and paid, and all amounts advanced and other balances due, with interest at the current rate, and all commissions fixed by the regulations and usages of the exchange or market where orders are executed shall be due and payable upon demand. I will at all times maintain margins for said accounts as from time to time required by you.

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Upon my death or failure to comply with any of the provisions hereof, or whenever you deem it necessary for your protection (it being understood that on transactions in securities when, as and if issued you are entitled to protection against your contingent liability pending the issue of the securities to the same extent as in purchases and sales of securities already issued and that you may purchase or sell odd lots on offer or bid without waiting for a round lot transaction) you are hereby authorized and empowered to cancel outstanding orders, sell, assign and deliver all or any part of the property or contracts for property held or carried for me and close out short sales by purchase upon any exchange or market or at any public or private sale at your option, all without demand for margin or notice of purchase or sale, which are expressly waived, and no specific demand or notice shall invalidate this waiver, and after deducting all costs and expenses of purchase or of sale and delivery, to apply the residue of the proceeds to the payment of my liabilities to you, returning the surplus, if any, to me, and I shall remain liable for any deficiency. At any such sale at public auction or on any exchange you may become purchasers for yourselves or in behalf of anyone else.

I expressly agree that you shall not be bound by any representation or agreement heretofore or hereafter made by any of your employees or agents which in any way purports to affect or diminish your rights under this agreement and that no representation or advice by you or your employees or agents regarding the purchase or sale by me of any property bought or sold on my order or carried or held in any manner for my account shall be the basis of any liability on your part to me.

Whenever any statute shall be enacted, or any regulation made under any statute or by the New York Stock Exchange, which shall be applicable to and affect in any manner or be inconsistent with any of the provisions hereof, the provisions of this agreement so affected shall be deemed modified or superseded, as the case may be, by such statute or regulation and all other provisions of this agreement and the provisions as so modified shall in all respects continue and be in full force and effect.

Whenever in your opinion circumstances require it, you may apply and/or transfer any of or all my equities interchangeably between all my said accounts, without notice to me in the premises, subject always to the rules and regulations under the Commodity Exchange Act.

I hereby ratify all transactions and dealings with property by you previous to the date hereof which would have been authorized by the terms of this agreement had they been subsequent hereto.

You are not to be in any way responsible or liable for any decline in price of property bought on my order, or carried or held in any manner for my account, nor for any rise in price of property sold short on my order.

My address herein below given is correct and shall be my address until I shall give you notification of a change by written notice received by you, and the sending of notices and other communications by you to such address or to such changed address shall be deemed personal delivery thereof to me.

I hereby represent that I am over 21 years of age and that I am not an employee of any exchange or of any corporation of which any exchange owns a majority of the capital stock, or of a member of or any firm registered on any exchange, or of a bank, trust company, insurance company or of any corporation, association, firm or individual engaged in the business of dealing, either as broker or principal, in stocks, bonds, or other securities or any forms of commercial paper, and if at any time during the life of this agreement I become so I will notify you. No one other than myself has or will have an interest in any account governed hereby except as I advise you in writing.

This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous and shall cover individually and collectively all accounts which the undersigned may open or reopen with you, and shall enure to the benefit of your present firm, and any successor firm or firms, irrespective of any changes or changes at any time in the personnel thereof, for any cause whatsoever, and of the assigns of your present firm or any successor firm, and shall be binding upon the undersigned, and/or the estate, executors, administrators and assigns of the undersigned.

Any controversy arising between us under this contract shall be determined by arbitration pursuant to the Arbitration Law of the State of New York, and under the rules of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or of the American Arbitration Association, or of the Arbitration Committee of the New York Stock Exchange or such other Exchange as may have jurisdiction over the matter in dispute, as I may elect. Any arbitration hereunder shall be before at least three arbitrators.

Signature Anthony Wilko

Address { 36 Pelham Parkway West / NO. AND STREET
New Rochelle, N.Y. / CITY OR TOWN

McCabe

ACCEPTED

HAYDEN, STONE & CO.

By C W Gillies

at NEW YORK, N. Y. [illegible] 19 [illegible]

On _____ 19____

NEW YORK
MARGIN AGREEMENT

Name
Anthony

WILKO, Anthony

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